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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-582

CHASE BRASS AND COPPER CO., INCORPORATED, *Appellant*,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Appellee*.

On Appeal From the Court of Appeal of California, First Appellate District

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

Committee on State Taxation of the
Council of State Chambers of Commerce

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INDEX

	Page
Opinions Below	2
Interest of Amicus Curiae	2
Argument	3
Conclusion	13
Appendix A-1	1a
Appendix A-2	2a
Appendix B	4a

CITATIONS

Cases:

Annel Holding Corp v. State Tax Commission, 355 N.Y.S. 2d 237 (1974) 12

Chase Brass & Copper Co., Inc. v. Franchise Tax Board, 70 Cal.App.3d 457, 138 Cal.Reptr. 901 (1977), U.S. Sup. Ct. Dkt. No. 77-582 (docketed Oct. 20, 1977) 2, 3, 7, 13

Coca Cola Company v. Department of Revenue, 271 Ore. 517, 533 P.2d 788 (1975) 12

Colonial Pipeline Co. v. Traigle, 421 U.S. 100 (1975) 5, 6

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 5, 6

Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931) 4

Interstate Finance Corp. v. Wisconsin, 28 Wis.2d 262, 137 N.W.2d 33 (1965) 12

Kennecott Copper Corp. v. State Tax Commission, 27 Utah2d 119, 493 P.2d 632 (1972), appeal dismissed, 409 U.S. 973, rehearing denied, 409 U.S. 1093 (1972) 8

Montana Department of Revenue v. The American Smelting and Refining Co., —— Mont. ——, 567 P.2d 901 (1977), U.S. Sup.Ct. Dkt. No. 77-658 (docketed Nov. 7, 1977) 7, 12

Page

Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959) 5
Skelly Oil Co. v. Commission on Taxation, 269 Minn. 351, 131 N.W.2d 632 (1964) 12
Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560 (1975) 5
United States Steel Corp. et al. v. Multistate Tax Commission, Docket No. 76-635, prob. juris. noted, 427 U.S. 1088 (1977) 7
Universal Manufacturing Corp. v. Brady, 320 So.2d 784 (Miss. 1975) 12
Woolworth Co. v. Director, 45 N.J. 466, 213 A.2d 1 (1975) 12
In re Wurlitzer Company v. State Tax Commission, 35 N.Y.2d 100, 315 N.E.2d 805 (1974) 12

STATUTES AND REPORTS:

U.S. Constitution 3
Due Process Clause 3, 4
Commerce Clause 3, 4, 6
Multistate Tax Commission, Res. #3 (5/4/77) 7, 4a
Multistate Tax Commission regulations 9
United Kingdom Treaty, Art. IX n.1, 7
H. Rep. No. 1480, 88th Cong., 2d Sess., Vol. 1, p. 245 (1964) 11
Report of Special Subcommittee on State Taxation of Interstate Commerce of H.R. Judiciary Committee, Vol. 4, H. Rep. No. 952, 88th Cong., 1st Sess. 1155 (1965) 10
Hearing by Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance, 93d Cong., 1st Sess. (1973) n.2, 8
Statement by Congressman Rodino on June 11, 1969 before H.R. Committee on Rules 6
123 Cong. Rec. S1623 (10/4/77) 11

Page

MISCELLANEOUS:

18 U.C.L.A. L. Rev. 478 (1971) 9
Peters, "State Income Tax Problems of Interstate Business," N.Y.U. 33rd Inst. on Fed. Tax. 899 (1975) 9
Cappetta, "Joint Audit Program of the Multistate Tax Commission," N.Y.U. 33rd Inst. on Fed. Tax. 961 (1965) 7
Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices," 42 J. Tax. 106 (1975) n.4, 10
W. Hellerstein, "State Taxation of Interstate Business and the Supreme Court," 1974 Term: Standard Pressed Steel and Colonial Pipeline, 62 Va. L. Rev. 149 (1976) n.2, 8
Shannon, "State Income Taxes—Living with Complexity," 30 Nat. Tax. J. 339 (1977) 12
L.A. Times, Oct. 17, 1977 ..... n.2, 9

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On Appeal From the Court of Appeal of California,
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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

This brief *amicus curiae* is filed on behalf of the Committee on State Taxation (COST) of the Council of State Chambers of Commerce pursuant to the consent granted by both parties. Copies of their letters of consent are reproduced in Appendix A.

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, is reported at 70 Cal. App. 3d 457, 138 Cal. Rptr. 901 (1977). Cross petitions for rehearing were denied by the Court of Appeal and cross petitions for hearing in the California Supreme Court were denied by that Court on August 11, 1977.

INTEREST OF AMICUS CURIAE

The Council of State Chambers of Commerce (COUNCIL), organized in 1931, consists of 33 chambers of commerce (29 state and 4 regional chambers). The Committee on State Taxation (COST), one of the COUNCIL's four advisory committees, consists mainly of corporations which conduct a substantial portion of the multistate and interstate business in the United States. One of COST's principal activities has been to work toward developing fair and equitable national standards in the income allocation and apportionment aspects of state taxation.

Member companies of COST, therefore, are representative of that part of the nation's business sector which is most directly affected by state taxes, including corporate franchise taxes imposed upon multistate and interstate business operations. COST is obviously and vitally interested in cases such as this one which present issues significantly affecting the uniformity, certainty and fair apportionment of taxes in each of the fifty states.

The particular interest of COST in this case is that it presents the fundamental and far-reaching issue of the extent of a state's power under the Due Process

and Commerce clauses to tax corporations operating within the state upon the basis of income earned outside of the state by independently operated out-of-state affiliates.

At the present time, 12 corporate members of COST have similar issues in the process of adjudication before the administrative agencies and the courts of California.

This Court's review of this case and its establishment of constitutional standards for state taxation of multistate businesses are urgently needed for the orderly growth of interstate commerce in the United States. They are also needed to provide a reasonably consistent and fair system of taxation throughout the nation which will allow each state to receive its just share of the total tax contribution of the nation's business sector. Finally, such review is needed to protect the constitutional rights of taxpayers in this era of rapidly increasing state and local revenue needs and the states' tendency toward delegation of the taxing authority among numerous local government units.

This brief seeks (1) to show that the decision of the Court of Appeal of California in this case is directly repugnant to longstanding judicial interpretation of the Due Process and Commerce Clauses of the Constitution and (2) to show the wide and adverse effect upon multistate business operations that decision will have, unless this Court undertakes to resolve the question presented.

ARGUMENT

The crux of the decision of the Court of Appeal of California in this case is that the state's franchise tax has been properly imposed upon Chase Brass and Cop-

per Co. (Chase) although measured in part by income earned by independent corporate affiliates of Chase, which income is in no way attributable to business operations or property owned within the State of California. It is a tax based, therefore, substantially upon extraterritorial income of corporations not subject to tax in California, which this Court traditionally has regarded as an undue burden upon interstate commerce under the Commerce Clause and a violation of the "nexus" and "minimum connection" requirements of the Due Process Clause.

The constitutional test established by the Court holds that a state tax on an interstate enterprise may not be sustained where the tax reaches activities carried on beyond the borders of the state. Where a state income tax reaches profits which are in no sense attributable to transactions within its jurisdiction, the Court has held the tax to be constitutionally invalid. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123 (1931).

California's application in this case of the "combined reporting" or "unitary" approach in the taxation of affiliated corporations violates this fundamental standard. As more fully described in the Jurisdictional Statement of Appellant, it includes within the basis for determining the amount of Chase's franchise tax liability the income earned by Kennecott Copper Corporation (Kennecott) and some of its subsidiaries on the sole ground that Kennecott owns a controlling stock interest in Chase and the other subsidiaries. In approving this approach the California court disregarded the facts that (1) neither Kennecott nor any of the subsidiaries, other than Chase, does any business in California, (2) Chase is operated independently from Kennecott and its affiliates and (3) all dealings

between Chase and Kennecott are conducted at arms' length and all purchases by Chase of Kennecott products are at standard and well-established market prices. In other words, this is a case where the evidence, coupled with the application of standard and generally accepted accounting principles, conclusively demonstrates that the income of Chase's independent affiliates is not in any way attributable to Chase's operations within the State of California. By disregarding these facts in imposing the tax in this case, California is attempting to tax Chase on the extraterritorial operations of its affiliates in violation of established constitutional standards.

Such extraterritorial taxation is precluded by the requirement that a state corporate net income tax be fairly and equitably apportioned to local activities or property within the taxing state. *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450 (1959). In three recent decisions of this Court affecting the jurisdictional reach of the states to tax interstate business, proper apportionment has been an essential element. *Standard Pressed Steel Co.* v. *Department of Revenue,* 419 U.S. 560 (1975); *Colonial Pipeline Co.* v. *Traigle,* 421 U.S. 100 (1975); *Complete Auto Transit, Inc.* v. *Brady,* 430 U.S. 274 (1977).

Thus, in *Colonial Pipeline,* this Court subscribed to earlier decisions which "have sustained nondiscriminatory, properly apportioned state corporate taxes upon foreign corporations doing an exclusively interstate business when the tax is related to a corporation's local activities and the State has provided benefits and protections for those activities for which it is justified in asking a fair and reasonable return." 421 U.S. at 108. In that case, the "fairly apportioned and nondiscrimi-

natory levy", 421 U.S. at 114, did not offend the Commerce Clause. In *Complete Auto Transit,* the attention of this Court was directed to the possibility that the tax in question might easily be tailored to single out interstate businesses and subject them to effects forbidden by the Commerce Clause. It was therein stated that: "Any tailored tax of this sort creates an increased danger of error in apportionment, of discrimination against interstate commerce, and of a lack of relationship to the services provided by the State." 430 U.S. at 288, n. 15.

Constitutionality turns on the presence of a direct and demonstrable relationship between the taxing jurisdiction and the net income of the person being taxed. The benefits and protection afforded by the taxing jurisdiction to the taxpayer are the constitutional premise upon which the validity of the tax reposes. Both elements are missing in the case at hand.

This issue is of national importance since it potentially affects every state and every group of affiliated corporations whose members operate in different states. As noted by Congressman Rodino in his June 11, 1969 statement before the Committee on Rules of the U.S. House of Representatives:

> "The number of jurisdictions taxing [the several hundred thousand companies engaged in interstate commerce] is staggering. There are in effect at the state level 42 sets of corporate income tax laws, 43 sales and use tax laws, 37 capital stock laws and 8 gross receipts tax laws of general applicability. In addition, to compound further the chaos and confusion, business taxes are rapidly proliferating on a local level—with sales taxes already imposed by about 3,000 localities, gross receipt taxes by over 1,000 and corporate income taxes by more than 200 local governments."

The potential effect of the *Chase* case extends to all of the state and local taxing jurisdictions employing taxes measured by income, and, of course, to any new state or local levies of this type.

The Multistate Tax Commission is urging the States to utilize combined reports. See Resolution No. 3 adopted by the Multistate Tax Commission on May 4, 1977 which is reproduced in Appendix B of this brief. A principal objective of the joint audit program of the Multistate Tax Commission is to find a unitary business relationship between affiliated corporations and encourage the use of combined reports. Cappetta, "Joint Audit Program of the Multistate Tax Commission," N.Y.U. 33rd Inst. on Fed. Tax. 961, 967-73 (1975).

Notwithstanding the statement made in the oral argument before the Court on October 11, 1977 in *United States Steel Corp. et al* v. *Multistate Tax Commission,* Docket No. 76-635, prob. juris. noted, 427 U.S. 1088 (1977), by William Dexter, attorney for Appellees that: "There is no audit that has ever been conducted by the Commission that touches upon the subject matter in the United Kingdom Treaty" (p. 28 of the Transcript),[1] there is no doubt but that the Commission has performed audits on a combined return basis. *Montana Department of Revenue* v. *The American Smelting and Refining Co.,* —— Mont. ——, 567 P.2d 901 (1977), U.S. Sup.Ct.Dkt. No. 77-658 (docketed Nov. 7, 1977).

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[1] Article IX of the Treaty would prevent states from including United Kingdom parents and their affiliates in a combined report

The full extent of the burden upon national commerce imposed by the decision in this case is substantially compounded by the often discriminatory taxation of affiliated corporations. This is illustrated by the fact that while California in this case has treated a multicorporate enterprise on a unitary basis to increase the taxpayer's tax obligation, Utah refused to balance the scales by applying that doctrine to the same taxpayer where it would result in a corresponding reduction in the tax obligation. (See *Kennecott Copper Corp.* v. *State Tax Commission,* 27 Utah 2d, 119, 493 P. 2d 632 (1972), *appeal dismissed,* 409 US 973, *rehearing denied,* 409 U.S. 1093 (1972).[2] The impact of such diversity in state taxation today is reflected in the current high levels of state corporate net income tax rates. For example, Kennecott Sales will pay tax on its entire net income to New York State and New York City at 1977 rates of 12% and 10.5%, respectively. If some portion of this net income is shifted to California by reason of that state's combined report procedures to that extent it will be subject to an additional tax of 9%.[3]

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of a related company doing business in such states. Thus, the subject matter of the Treaty does concern combined returns.

[2] Refusal to give plenary consideration to the Kennecott case and this case when first appealed prompted one commentator to say that this Court "has for the most part remained on the sidelines" with respect to the issue of what constitutes fair apportionment. W. Hellerstein, "State Taxation of Interstate Business and the Supreme Court," 1974 Term: *Standard Pressed Steel and Colonial Pipeline,* 62 Va. L. Rev. 149 (1976). The reticence may account in part for the fierce opposition by state tax administrators to any federal legislation providing uniform standards. Hearings by the Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance, 93rd Cong., 1st Sess. (1973).

[3] Some indication as to the extent of the extraterritorial taxation

The problem of discriminatory application is exacerbated by reason of the lack of statutory provisions spelling out the circumstances under which the method can and must be used—leaving this decision to the absolute discretion of the state collecting agencies and the absence of definitive regulations. California has issued a 15-page booklet that simply paraphrases the wording of certain decisions of the courts as to what constitutes a unitary business (the determinative factor with respect to combined reporting in California); the Multistate Tax Commission uniform regulations adopted by a number of states provide that nothing in the regulations precludes the use of a combined report; and most states have no regulations at all. Uncertainty as to the proper method for members of a multicorporate, interstate enterprise to determine their state tax liabilities is compounded by the fact that a number of state tax administrators are requiring combined reports where there is no specific statutory authority for requiring such reports, on the ground that the general apportionment provisions of the tax law are broad enough to require the combining of the "unitary" business income and factors of the affiliated group. Peters, "State Income Tax Problems of Interstate Business", N.Y.U. 33rd Inst. on Fed. Tax 899, 931-40 (1975). The elusive nature of the unitary concept is eloquently expressed by Professor Gary Boren in the following words:

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problem in this one state may be found in the remarks of Martin Huff, Executive Officer of the California Franchise Tax Board to the effect that if California were prohibited from including the net income and factors of non-United States corporations in combined reports, it would reduce the state's revenues by about $125 million. *L.A. Times,* Oct. 17, 1977. While such an estimate is highly speculative, it reflects the current position of the Franchise Tax Board staff.

> "The tests formulated by the courts to determine when a business is unitary have been all but useless. In addition, it is difficult to glean from the opinions any consistent pattern of analysis in ascertaining the applicability of separate accounting." [18 U.C.L.A. L. Rev. 478, 532 (1971)].

Indeed, the tests have become so meaningless and their application so subjective that the person most responsible for their formulation and acceptance in California tax law has proposed that they be dispensed with altogether and that controlling ownership of stock be the determining factor with respect to the requirement of a combined report.[4]

The Attorney General of California joined Kennecott in asking this Court to review the Utah decision and in its brief amicus curiae stated that harmonization of such conflicting methods of apportioning net income among the states for taxation was a substantial federal question warranting this Court's intervention. Brief of the State of California as Amicus Curiae, pp. 3, 5, 10. It is universally recognized that there is a need for uniform application of the combined report concept by those states choosing to utilize it.

The problem was specifically noted in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the U.S. House of Representatives, Vol. 4, H. Rep. No. 952, 89th Cong., 1st Sess. 1155 (1965), as follows:

> "The present 'unitary business' rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole."

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[4] Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices," 42 J. Tax. 106 (1975).

The Report goes on to state that the establishment of a national standard in this area "will result in a significant measure of relief from the multiplicity and diversity of the present system." *Id.* at 1205-06. The need for a federal review of the impact of conflicting state laws on interstate commerce has been more recently expressed by Senator Mathias (123 Cong. Rec. S 1623, October 4, 1977) as follows:

> "Our Constitution was written as a compact between States willing to trade short-run gains for long-term progress in an orderly Federal system of free-flowing commerce.
>
> "Today that system is not functioning as efficiently as it should. A major obstacle to interstate commerce lies in the complex and often conflicting local tax rules which confront firms in interstate commerce. These rules harm both business and our state and local governments—and, in the end, deprive all our citizens of the efficiency which leads to lower prices and the tax revenue which finances government services."

Finally, in its study of this problem the House's special subcommittee implicitly anticipated the need for this Court's ultimate resolution of the many conflicts and uncertainties in this area when it stated:

> "First of all, the [unitary business or combined report] concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. *This may arise as a constitutional question* or in terms of the limitations on State taxing power imposed by Public Law 86-272."
>
> "In the latter case, the question is whether a State may require a company within its taxing jurisdic-

> tion to include in the measure of its tax income from an affiliate which is covered by an exemption in that statute. This question is unsettled, and as a result at least one state, California—the leading exponent of the combined report concept—anticipates that it will have to litigate the issues involved." [Emphasis added; footnote omitted; H. Rep. No. 1480, 88th Cong., 2d. Sess., vol. 1, p. 245. (1964)]

The serious constitutional problems concerning state taxation of affiliated corporations can be resolved only by this Court. The courts of the several states are ever more frequently being confronted with cases involving the federal issues raised by this appeal and their conflicting decisions are irreconcilable. *Skelly Oil Co.* v. *Commission of Taxation,* 269 Minn. 351, 131 N.W. 2d 632 (1964); *Woolworth Co.* v. *Director,* 45 N.J. 466, 213 A. 2d 1 (1965); *Interstate Finance Corp.* v. *Wisconsin,* 28 Wis. 2d 262, 137 N.W. 2d 38 (1965); *Coca Cola Company* v. *Department of Revenue,* 271 Ore. 517, 533 P. 2d 788 (1975); *In re Wurlitzer Company* v. *State Tax Commission,* 35 N.Y. 2d 100, 315 N.E. 2d 805 (1974); *Annel Holding Corp.* v. *State Tax Commission,* 355 N.Y.S. 2d 237 (1974); *Universal Manufacturing Corp.* v. *Brady,* 320 So. 2d 784 (Miss. 1975); *Montana Department of Revenue* v. *The American Smelting and Refining Co., supra.* The result has been a widening disagreement over the constitutional restraints on the states' power to tax affiliated corporations and an ever-increasing diversity of patterns of state taxation where uniformity is needed to prevent over or under taxation of such corporate groups. See Shannon, "State Income Taxes—Living with Complexity," 30 Nat. Tax J. 339 (1977). The result of this conflict and lack of uniformity is uncertainty as to

the rights of affiliated corporations which will impede the orderly growth of national commerce and promote an unfair apportionment of revenue among the states. The magnitude of these problems inevitably increases as state revenue needs grow (state taxes rose 14.1% or $12 billion, in the twelve-month period ending March 1977), as the number of taxing authorities is increased by delegation of state taxing authority to local governments, and as the states increasingly look beyond their borders to meet their tax needs.

CONCLUSION

Amicus Curiae submits that the *Chase* case reflects an arbitrary assumption of state taxing authority which violates established constitutional limitations. The case affords the basis for a needed review by this Court of the right of a state or local government to base a tax upon income derived outside its borders by corporations not subject to its jurisdiction through the application of presumptions in the face of facts to the contrary. Such a review is of high interest to the proper economic development of the United States and to business done within it.

Respectfully submitted,

GEORGE S. KOCH
Counsel

Attorney for the Committee on State Taxation of the Council of State Chambers of Commerce

APPENDIX

APPENDIX A-1

STATE OF CALIFORNIA

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November 2, 1977

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Dear Mr. Koch:

Re: Chase Brass and Copper Co., Incorporated v. Franchise Tax Board of the State of California, No. 77-582, O.T. 1977

You have our consent to file an amicus curiae brief in support of appellant's jurisdictional statement in the above matter.

Very truly yours,

EVELLE J. YOUNGER
Attorney General

/s/ TIMOTHY G. LADDISH
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APPENDIX A-2

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Re: Chase Brass & Copper Co. v.
Franchise Tax Board
No. 77-582, October Term, 1977,
United States Supreme Court

Dear Mr. Koch:

Replying to your letter of October 27th, I am glad to consent to your filing an amicus curiae brief in this case, in support of the position taken in our jurisdictional state-

ment that there are substantial federal questions justifying plenary consideration.

Sincerely yours,

/s/ VALENTINE BROOKES
/s/ VALENTINE BROOKES
Attorney for Appellant,
Chase Brass & Copper Co., Inc.

VB:chp
cc: Eugene Bock, Esquire

APPENDIX B

RESOLUTION #3

BE IT RESOLVED THAT:

1) It is the official policy of the Multistate Tax Commission that the unitary business concept is appropriate for attributing income with respect to all businesses affected by the Uniform Division of Income for Tax Purposes Act; and that

2) It is appropriate on a worldwide as well as a domestic basis regardless of whether the parent or some or all of the subsidiaries are located outside or inside the United States; and that

3) The Commission recommends that each state pursue the policy recommended in this resolution to the full extent permitted by its laws; and that

4) Where a state's laws do not permit complying with this recommendation, efforts be made to amend those laws in order to effect such a result.

MULTISTATE TAX COMMISSION

May 4, 1977, Denver, Colorado

Annual Meeting